

IN THE
United States
Court of Appeals
FOR THE NINTH CIRCUIT

CLARK SQUIRE, United States Collector
of Internal Revenue for the State of
Washington,

Appellant

vs.

PUGET SOUND PULP & TIMBER CO.,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION.

HONORABLE LLOYD L. BLACK, *Judge*

BRIEF FOR THE APPELLANT

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
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J. CHARLES DENNIS,
United States Attorney.

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1017 UNITED STATES COURT HOUSE
SEATTLE 4, WASHINGTON

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OPINION BELOW

The opinion of the District Court (R. 83-96) is
not reported.

JURISDICTION

This appeal involves interest in the amount of
\$11,640.98 paid on excess profits taxes for the cal-
endar year 1942. (R. 105-106.) The interest in ques-

tion was paid to the Collector of Internal Revenue, appellant, on November 30, 1944. (R. 99.) Taxpayer filed a claim for refund, based upon the grounds sued upon, on November 30, 1944. (R. 102.) The claim for refund was rejected by the Commissioner of Internal Revenue on March 21, 1945. (R. 102.) Suit was brought within the time provided in Section 3772 of the Internal Revenue Code or on October 18, 1946 (R. 2-16), for the recovery of the interest claimed. Jurisdiction was conferred on the District Court by 28 U.S.C., Sec. 1340. Judgment was entered on July 11, 1949. (R. 105-106.) Notice of appeal was filed August 19, 1949 (R. 107), pursuant to the provisions of 28 U.S.C., Sec. 1291.

QUESTION PRESENTED

Was taxpayer required to pay interest on excess profits taxes deferred under Section 710 (a) (5) of the Internal Revenue Code during the pendency of its application for relief under Section 722 of the Internal Revenue Code, where its application for relief was denied?

STATUTE INVOLVED

The pertinent statute will be found in the Appendix, *infra*.

STATEMENT

The facts were not in dispute. The pertinent facts were found (R. 99-102) as follows:

Taxpayer filed its income and excess profits tax return for the calendar year 1942 on March 15, 1943, claiming the benefits of Section 722 of the Internal Revenue Code. (R. 100.) There was reported excess profits net income (without reference to Section 722) of \$1,884,586.83, and normal tax net income (computed without the credit provided in Section 26 (e) of the Internal Revenue Code of \$2,533,133.02. The excess profits net income was, it will be noted, more than 50% of the adjusted normal tax net income which entitled taxpayer, under Section 710 (a) (5) of the Internal Revenue Code, to defer 33% of the excess profits tax on the adjusted excess profits net income returned. (R. 100-101.)

The tax on the adjusted excess profits net income shown on the return was handled as follows (R. 100-101):

(1) The sum of \$1,410,924.79 in tax was paid at the time of the filing of the return.

(2) The sum of \$150,000 was satisfied by a credit to which taxpayer was entitled and is not here in issue.

(3) The balance, or \$135,203.36, was deferred under Section 710 (a) (5) of the Internal Revenue Code.

On August 29, 1944, the Commissioner of Internal Revenue determined that taxpayer was not entitled to relief under Section 722 of the Code and on September 30, 1944, advised taxpayer of a deficiency in excess profits taxes of \$135,203.36, with interest thereon from March 15, 1943. (R. 101.) The assessed deficiency and interest was paid on October 14, 1944 (R. 101), and a timely claim for refund was filed for the refund of the interest here in question (R. 102).

The District Court concluded that interest on the deficiency in excess profits taxes of \$135,203.36 did not start to run until the application for relief under Section 722 of the Code was denied and notice and demand was made by the Commissioner of Internal Revenue on the taxpayer. (R. 102-103.) Judgment was rendered for the taxpayer in the sum of \$11,640.98 representing the interest sought to be recovered on the deferred excess profits taxes from March 15, 1943, to September 30, 1944. (R. 103-106.)

STATEMENT OF POINT TO BE URGED

The District Court erred in concluding and hold-

ing that taxpayer was not liable for interest on deferred excess profits taxes from the date of deferment to the date the Commissioner determined that taxpayer was not entitled to relief under Section 722 of the Internal Revenue Code.

SUMMARY OF ARGUMENT

The validity of the Commissioner's determination that taxpayer is not entitled to relief under Section 722 of the Internal Revenue Code is not here at issue. The sole question is whether interest on the amount of excess profits tax deferred under Section 710 (a) (5) of the Internal Revenue Code was properly assessed and collected for the period from March 15, 1943, to the Commissioner's determination that taxpayer was not entitled to relief and notice thereon was given taxpayer. It is Collector's position that the court erred in granting judgment for taxpayer for the interest paid, on the ground that Section 292 (b) of the Internal Revenue Code, providing that no interest shall be assessed or collected on a deficiency determined by the Commissioner to be attributable to the final determination of an application for relief under Section 722 of the Code, was applicable only where the application for relief was granted, and on the further ground that even

if Section 292 (b) of the Code applies where the application for relief is denied, excess profits taxes deferred under Section 710 (a) (5) of the Code is specially excluded from the non-interest provisions of Section 292 (b) of the Code.

ARGUMENT

THE ASSESSED DEFERRED EXCESS PROFITS TAXES BORE INTEREST FROM THE DATE OF DEFERMENT

Section 722 (a) of the Internal Revenue Code (Appendix, *infra*) provides that—

In any case in which taxpayer establishes that the tax [excess profits taxes] computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purpose of an excess profits tax based upon comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. * * *

The companion statute, Section 710 of the Internal Revenue Code (Appendix, *infra*), provides that where the adjusted excess profits net income com-

puted without reference to Section 722 of the Code for the taxable year of a taxpayer who claims the benefits of Section 722, is in excess of 50% of its normal tax net income for such year computed without the credit as provided in Section 26 (e) of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 26), the taxpayer may defer 33% of the excess profits tax which taxpayer would otherwise be required to pay at the time of the filing of the return and the tax reduced shall, for the purposes of Section 271 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 271), be considered the amount shown on the return. That section also provides that a deficiency in the amount deferred may be assessed at any time before the expiration of one year after the final determination of the Commissioner on taxpayer's application for relief.

Section 292 (b) of the Internal Revenue Code (Appendix, *infra*) provides that if any part of a deficiency for a taxable year beginning after December 31, 1941 (the taxable year here was 1942), is determined by the Commissioner to be attributable to the final determination of an application for relief under Section 722 of the Code, no interest shall be assessed or paid thereon for a period prior to one year after the filing of the application or September

16, 1945, whichever is the latter.¹ That section contains an exception to the non-interest provisions—

* * * (excluding any portion of a deficiency of excess profits taxes constituting a deficiency by reason of deferment of tax under section 710 (a) (5), and excluding, in case the taxpayer has availed itself of the benefits of section 710 (a) (5), such portion of a deficiency under Chapter 1 as may be determined by the Commissioner to exceed any refund or credit of excess profits tax arising from the operation of section 722)
* * *

We believe that the District Court misinterpreted Section 292 (b) of the Code, for the reasons that (1) the section applied only where relief under Section 722 was granted and (2), if it were otherwise, excess profits taxes deferred under Section 710 (a) (5) are specifically excluded from the non-interest provisions of Section 292 (b). Relief under Section 722 would generally result (except as to the amount deferred) in a refund of excess profits taxes paid

¹ Correspondingly, Section 3771 (g) of the internal Revenue Code (26 U.S.C. 1946 ed., Sec. 3771) provides that if any part of an overpayment is determined by the Commissioner to be attributable to the final determination of an application for relief under Section 722 of the Internal Revenue Code (no interest shall be allowed or paid with respect to such part of the overpayment for any period prior to one year after the filing of such application, or September 16, 1945, whichever is the latter.

and an increase in taxpayer's income taxes.² In such a case there would be no interest payable on the refund of excess profits taxes and no interest assessed on the income tax deficiency.

The very heading of Section 292 (b) stating "Deficiency Resulting from Relief Under Section 722" supports Collector's contention that Section 292 (b) is only applicable when an application for relief or benefit under Section 722 is granted. This contention is further supported by the discussion in Congress and the Committee Reports relating to H. R. 3363 which added Section 292 (b) to the Internal Revenue Code. Congressman Doughton, in introducing this bill in the House, stated (89 Cong. Record, Part 6, p. 8191):

The existing law requires that the Federal Government pay 6 percent interest on all refunds made to the taxpayer and that it collect 6 percent interest on all deficiencies paid to the Government; the interest to begin running from the date the overpayment was made in the case of a refund, and from the date the tax should have been paid in the case of a deficiency.

² A reduction of excess profits taxes would in turn increase the income taxes by decreasing the deduction of income subject to excess profits taxes as provided in Section 26 (e) of the Internal Revenue Code, as amended by Section 105 (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798 (26 U.S.C. 1946 ed., Sec. 26).

Since Section 722 of the Internal Revenue Code is for the relief of the taxpayer, and since it was made retroactive from the date of its enactment in October 1942 to the years 1940 and 1941, it is believed to be equitable to both the Government and the taxpayer not to pay interest on refunds, nor to collect interest on deficiencies for those 2 years when the refund or deficiency arises out of the application of Section 722. With respect to the year 1942, and subsequent years, it is also believed to be equitable for interest not to begin to run on refunds or deficiencies arising out of the application of this relief provision until September 16, 1945, or 1 year after an application for relief has been filed, whichever is later. The reason for this is because more than 25,000 applications have already been filed with the Commissioner of Internal Revenue, and a reasonable time should be given to the Commissioner to examine the complicated data filed in support of the claims before the Government is compelled to pay interest on any refunds which may be made or to collect interest on any deficiencies which may be assessed as a result of adjustments in other taxes following the granting of the relief under Section 722.

And, in the report from the Committee on Ways and Means accompanying the bill, it was stated (H. Rep. No. 722, 78th Cong., 1st Sess., p. 2):

The bill provides that no interest shall be allowed on overpayments attributable to determinations under Section 722 with respect to taxable years beginning in 1940 and 1941. Correspondingly, no interest will be collected on deficiencies resulting from such determinations for those years. Since Section 722 as amended by the Revenue Act of 1942 was made retroactive

to grant relief for taxable years beginning in 1940 and 1941, it is believed proper not to allow interest on overpayments or collect interest on deficiencies resulting from the application of this section to such years. With respect to 1942 and subsequent years, interest on overpayments and on deficiencies arising from the application of this section is not allowed for any period prior to September 16, 1945, or prior to 1 year after the filing of the application, whichever is the later.

As the claim for relief under the provisions of Section 722 involved here was rejected by the Commissioner, the determination of the deficiency in excess profits tax did not result from relief under Section 722, and Section 292 (b) is not applicable.

The court in *Jones v. Johnson*, 176 F. (2d) 693 (C.A. 10th), held that interest on an assessment of excess profits taxes made after the denial of an application for relief under Section 722 of the Code was properly assessed and collected. While it does not appear in the opinion, taxpayer in that case did not contest interest paid on the portion of the deficiency assessment representing the excess profits taxes deferred under Section 710 (a) (5) of the Code; the litigation concerned interest on the amount of the excess profits tax deficiency in excess of the deferred tax. However, it would be an anomalous situation if interest could not be collected on the portion of the deficiency deferred and at the same time

collected on the deficiency in excess of the amount deferred. The decision in the *Jones* case, *supra*, was, we think, based on the ground urged by the Government that Section 292 (b) of the Code applied only where the application for relief or benefit under Section 722 was granted.

Even if this Court should conclude that Section 292 (b) may apply where relief is denied, judgment in this case should be reversed for the reason that the section specifically excludes from non-payment of interest excess profits taxes deferred. The statute excludes "any portion of a deficiency of excess profits taxes constituting a deficiency by reason of deferment of tax under Section 710 (a) (5)". The lower court interpreted that portion of the section to mean merely that the deferred tax (R. 90) "shall not be freed of interest until a date as late as September 16, 1945" and held (R. 93) "that interest was not chargeable until the deferred deficiency became payable", meaning upon denial of the application for relief and notice to the taxpayer. The lower court overlooked the fact that except for the provisions of Section 710 (a) (5) of the Code the entire excess profits tax would have been due March 15, 1943. Section 292 (b) in effect excludes from its provisions Section 710 (a) (5); consequently, from the standpoint of interest

the deferred tax was due March 15, 1943, and bore interest under Section 292 (a) of the Internal Revenue Code (Appendix, *infra*) from that date. The lower court's interpretation of the pertinent portion of Section 292 (b) renders that part of the section uncertain and virtually inoperative as well as discriminatory as against taxpayers who did not qualify for the deferment. Those taxpayers who paid the tax were deprived of the use of their money and, where the application was granted, received no interest thereon. The legislative history shows that Congress recognized that inequities would result unless interest was payable on the portion of the deficiency deferred. The report of the Committee on Finance in connection with the bill (H. R. 3363) adding Section 292 (b) to the Internal Revenue Code, stated (S. Rep. No. 508, 78th Cong., 1st Sess., p. 2):

The report set forth below of the Committee on Ways and Means of the House of Representatives states the purposes of the bill in extending the time for application under Section 722 of the Internal Revenue Code, and in making special provisions with respect to interest on overpayments and deficiencies attributable to determinations under that section. The committee amendment of Section 2 is designed to make appropriate provision for application of the section where there has been deferment of part of the excess-profits tax under Section 710 (a) (5) of the code. In general, a taxpayer must pay its tax, computed without any benefit, from the applica-

tion of Section 722. Since, under the bill, taxpayers which have paid their taxes in full, without the application of Section 722, will receive any refunds with interest only for the periods provided, taxpayers who have availed themselves of the deferment provided by Section 710 (a) (5) should be required to pay interest on the amount which they have underpaid.

We submit that the pertinent portion of Section 292 (b) of the Code requires that interest be collected on the deficiency of excess profits taxes deferred under Section 710 (a) (5). The meaning of the statute, read in the light of the committee report, above quoted, leaves no doubt as to what was intended. This case is precisely the situation Congress had in mind.

CONCLUSION

The judgment of the District Court is erroneous and should be reversed.

Respectfully submitted,

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January, 1950.

APPENDIX

Internal Revenue Code:

SEC. 292 [as amended by Section 2, Act of December 17, 1943, c. 346, 57 Stat. 601]. INTEREST ON DEFICIENCIES.

(a) *General Rule.*—Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, or, in the case of a waiver under Section 272 (d), to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier. If any portion of the deficiency assessed is not to be collected by reason of a prior satisfaction, in whole or in part, of the tax, proper adjustment shall be made with respect to the interest on such portion.

(b) *Deficiency Resulting From Relief Under Section 722.*—If any part of a deficiency for a taxable year beginning prior to January 1, 1942, is determined by the Commissioner to be attributable to the final determination of an application for relief or benefit under Section 722 for any taxable year, no interest shall be assessed or paid with respect to such part of the deficiency. If any part of a deficiency for a taxable year beginning after December 31, 1941, is determined by the Commissioner to be attributable to the final determination of an application for relief or benefit under Section 722 for any taxable year

(excluding any portion of a deficiency of excess profits taxes constituting a deficiency by reason of deferment of tax under Section 710 (c) (5), and excluding, in case the taxpayer has availed itself of the benefits of Section 710 (a) (5), such portion of a deficiency under Chapter 1 as may be determined by the Commissioner to exceed any refund or credit of excess profits tax arising from the operation of Section 722), no interest shall be assessed or paid with respect to such part of the deficiency for any period prior to one year after the filing of such application, or September 16, 1945, whichever is the later.
[26 U.S.C. 1946 ed., Sec. 292.]

SEC. 710 [as added by Section 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974]. IMPOSITION OF TAX.

(a) *Imposition.*—

* * * *

(5) [as added by Section 222 (b), Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Section 3 (a), Act of June 12, 1948, Public Law 635, 80th Cong., 2d Sess.] *Deferment of payment in case of abnormality.*—If the adjusted excess profits net income (computed without reference to Section 722) for the taxable year of a taxpayer which claims on its return, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, the benefits of Section 722, is in excess of 50 per centum of its normal tax net income for such year, computed without the credit provided in Section 26 (e) (relating to adjusted excess profits net income), the amount of tax payable at the time prescribed for payment may be reduced by an amount equal to 33 per centum of the amount of the reduction in the tax so claimed. For the

purposes of Section 271, if the tax payable is the tax so reduced, the tax so reduced shall be considered the amount shown on the return. Notwithstanding any other provision of law or rule of law, to the extent that any amount of tax remaining unpaid pursuant to this paragraph is in excess of the reduction in tax finally determined under Section 722, such excess may be assessed at any time before the expiration of one year after such final determination.

* * * *

[26 U.S.C. 1946 ed., Sec. 710.]

SEC. 722 [as added by Section 201, Second Revenue Act of 1940, *supra*, and as amended by Section 222 (a), Revenue Act of 1942, *supra*]. GENERAL RELIEF — CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

(a) *General Rule.*—In any case in which the taxpayer establishes that the tax computed under this subchapter (without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter. In determining such constructive average base period net income, no regard shall be had to events or conditions affecting the taxpayer, the industry of which it is a member, or taxpayers generally occurring or existing after December 31, 1939, except that, in the cases described in the last

sentence of Section 722 (b) (4) and in Section 722 (c), regard shall be had to the change in the character of the business under Section 722 (b) (4) or the nature of the taxpayer and the character of its business under Section 722 (c) to the extent necessary to establish the normal earnings to be used as the constructive average base period net income.

[26 U.S.C. 1946 ed., Sec. 722.]